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Homo Oeconomicus as *Menschenbild: Reforms in Indonesia*

Paul H. Brietzke*
November 1999

We assemble to honor a colleague fully as noble as he is scholarly. That "Heinz" Scholler and I have remained fast friends, despite our having written books and articles together, testifies to his tolerance and attitudes that are humanistic as well as humane. Casting about for a topic with which to honor him, I had to draw upon my current experiences as Legal Advisor, Ministry of Justice, Republic of Indonesia. On the one hand, there is the excitement of my playing a small role in building what may become the world's third largest democracy. But the dark side of my experiences involves hangovers or holdovers from an elitist, rather authoritarian and human rights abusing, Indonesian past. The Chinese have a *curse* rather than a blessing: "May you live in interesting times." Times in Indonesia are certainly interesting, and they are best portrayed through a mix of politics, economics, law, and culture that German colleagues might identify with the work of Max Weber—except that I'll be brief and omit the many footnotes that otherwise disfigure much of my (and Weber's) work. Also, I won't bore you with all of the analyses that support my Law and Economics-style arguments.

In an earlier article (Brietzke & Timberg, 1999), I showed how the Indonesian economic crisis—more severe and longer lasting than most others in Asia—and the political crisis that led to the collapse of Soeharto's New Order regime and the struggle for *Reformasi*, occurred at the same time (late 1977 to the present) and for the same reasons. (n. 1) While some needed reforms have begun, much remains to be done. The current structure of the Indonesian economy has less to do with the economic productivity of businesses over time than with their political productivity: the unstable and grossly unequal power positions that emerged during colonialism and Soeharto's New Order. More rapid economic growth, and especially development, will result from a greater economic *pluralism* in Indonesia: economic sectors and institutions (n. 2) growing more equal in the terms of trade (largely as defined by law) that govern their exchanges. This pluralism would: diversify economic risks; take advantage of differences in the institutions' ability to adjust to crises and other changes, to use various technologies, and to raise capital by various means; make it more difficult for a particular elite to dominate Government *and* the economy; and, above all, increase the number of viable niches in the economy—especially for the poor and powerless.

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Indonesia should aim for a legal framework which promotes economic activity—reduces risks and transaction costs by contractual means, etc.—across institutions and sectors: a "level playing field" or conscious legal neutrality, *except* as legal discriminations enable the poor and powerless *efficiently* to create or enter more productive economic institutions. Legal reforms should be like a (democratic) handicapping of an economic 'horserace': lighten the load on all of the institutional 'horses', to make them run better, but lighten the load even more on those which have fallen behind because of particularly heavy burdens carried in the past. The regulatory burden on all of the Indonesian horses is currently so heavy that the wonder is their being able to run at all.

Jurisprudentia

Most Festschrift contributions have a theoretical section that attempts to open a common ground with the other participants, and with past analyses by the honoree. I will try to do this in the form of five "precepts" to guide economic reforms in Indonesia—and, indeed, elsewhere. The *Menschenbild* is developmental, of course: promoting the growing respect for dignity and other human rights that is inseparable from both democratization and reductions in poverty.

First Precept: all institutions fail precisely because they are human and based on human law interacting with self-interest and culture (*infra*). Just as divorces are a marriage failure, there are market failures, bankruptcies (enterprise failures), bureaucratic failures (over-regulation and corruption, for example), and political failures (East Timor and corruption, for example). Even constitutions are known to fail on occasion. The reformist implications seem clear: design the best institutions you can (*infra*); recognize that growth, development, and the other transitions that a country like Indonesia experiences put enormous strains on institutions, so refrain from imposing unnecessary (especially regulatory) strains on them; give institutions a chance to develop, by reforming them as part of a coherent and sequenced plan (*infra*), rather than changing them every few years—Indonesian bankruptcy laws, for example; and then live with the (much-reduced) institutional failures that will inevitably remain. The goal of the designs and plan is to minimize the *net* of failures throughout the economy and society.

From this perspective, politics and the state are neither (nearly) all-bad nor (nearly) all-good. Rather, they will fail about as often as other institutions, and they are thus the problem and the solution (to development problems, for securing other human rights, etc.) in roughly equal measures. The policy goal is to suppress the governmental mischief wherever possible, and to advance the governmental remedy wherever necessary. It is fortunate that a *private* process of institutional reform is also going on, a process which can also be strengthened through legal reforms. While marketplace exchanges obviously involve contracts, actors can also use contracts to create market *surrogates* (enterprises, such as companies or political parties), to achieve their aims and reduce risks and transaction costs in the process.

Second Precept: Like others, *Indonesians should (democratically) decide what is private activity,* and thus subject to private law, *and what is public activity,* and thus subject to public law. The policy problem is that almost any large allocation or reallocation of resources acquires a public character because of its impact on development prospects. Lawyers frequently tie themselves in knots, while making the elaborate public/private law distinctions that should be matters of analytical convenience only. But economists do exactly the same thing, with their macro/microeconomics distinction that neatly overlaps with the lawyers' dichotomy. For

example, the regulation of pollution is an unwelcome interference from the factory owner's, private law (broad property rights, *infra,* for example), microeconomics perspective. But the same regulation *may* be a necessary corrective for failures in markets, and in individual and organizational behavior, from the community's, public law, macroeconomic perspective. Which perspective should be adopted in which circumstances, since lawyers and economists are unwilling and unable to collapse their cherished dichotomies into a single standard?

This analytical dualism causes much confusion, in Indonesia and elsewhere. For example, Indonesian bankruptcy law reform is essential to economic growth and strengthening markets: in addition to an ease of entry, there should be ease of exit from markets—so that the failures' assets can be reassembled for productive purposes. But bankruptcy reform is a private law, microeconomic solution: designed to be under private creditors' negotiation and control. Contrary to the beliefs of some, it will thus provide little or no relief from the macroeconomic consequences of Indonesia's economic Crisis: the massive currency devaluations, etc. that led to business failures on a scale with which no bankruptcy law on earth could cope.

The main reformist implication of this second precept is to highlight the importance of reforms in administrative law and institutions (*infra*). However, in Indonesia and elsewhere, elites are constantly trying to change what is private and what is public in self-serving ways which masquerade as "the national interest." How, politically are Indonesians going to determine which justifications for change are valid, and which are merely an elites' "business as usual?" All democracies struggle with this challenge, of defining the national interest/common good in ways that command an informed consensus.

The *third precept* is as easy to state as it is difficult to explain: *law tends to over-determine what it under-categorizes.* This jurisprudential insight struck me while considering Indonesian reforms, probably because a traditional civil law/regulatory system like Indonesia's offers an extreme example of tendencies present in all legal systems. A civil law system attempts to create a highly prized coherence and consistency by exhaustively enumerating institutional types and functions—i.e., by fully stipulating all statuses--in advance. Due to a failure of legal changes to keep pace with economic changes, the categories of statuses permitted by the law are insufficiently rich to facilitate the many niche activities that characterize a complex modern economy. In other words, Indonesian law under-categorizes economic activity and, apparently to regulate activities in detail and to conserve coherence and consistency, Indonesian law permits relatively little private law reform *(supra)*: the "customizing" of institutions and transactions by the parties, to achieve their aims through contractual means that reduce risks and transaction costs.

Arguably, Indonesian law thus over-determines what it under-categorizes. Absent legal reforms, Douglas North's (quoted by Trebilcock, 1997, 45) "institutional sclerosis" will continue to plague Indonesia—and many other countries as well. Useful reforms would eliminate many (inefficient, unnecessary, and corruption-provoking) business licensing requirements, permit cheap limited-liability partnerships and closely-held corporations, and allow non-governmental, perhaps non-profit, organizations to conduct business in their own names.

Combining the first three yields a *fourth precept: design and redesign institutions to embody clear goals, a good 'fit' with other institutions, and the best incentives and organizations that selectively adapt and adopt existing cultures.* Complex analyses based on organization theory

are presented elsewhere—Brietzke, 1999—and are thus not repeated here, but brief mention will be made of cultural issues that are presumably of more interest to the assembled colleagues. Such issues used to be treated simply, as a need to respond to "Asian values", but the public increasingly realizes how these values are manipulated in self-serving ways by their pre-democratic advocates. Some cultural changes are desirable and even essential to an institutional and general development in Indonesia, but there are also many ways of designing institutions, and re-designing those responding to archaic forms of colonial (Dutch) and Javanese culture, so as to respond to (democratically-expressed) Indonesian needs and desires.

The often-agonizing ferment Indonesians are experiencing—economic recession, unrest and violence, marketization, democratization—can have two contradictory effects. It makes people seek renewal or a sense of direction in some traditional (especially religious) way of doing things, while also exposing shortcomings in these ways and encouraging certain kinds of cultural experimentation. Policymakers can seek to bend such contradictions in developmental directions, and I argue (Brietzke, 1999; Brietzke and Timberg, 1999) that the best place to start is the bureaucracy— by turning repressive colonial institutions into a *civil service*. Like other institutional actors, bureaucrats resist change. But they are also potent change-agents, once their culture is transformed: through reformed incentives, organizations and ideologies, and an improved education and training.

I close with a *fifth precept: the need to devote attention and resources to the effective implementation of reforms.* Otherwise, a mismatch arises, between ambitious changes in substantive Indonesian laws and an underdeveloped institutional capacity to apply them—especially through courts and administrative bureaus (*infra*). As Portia says: "If to do were as easy as to know what were good to do, chapels had been churches and poor men's cottages princes' palaces." (Shakespeare, *Merchant of Venice*, I, ii, 13-15.) Predictable enforcement is required for a stable institutional environment. Predictability requires marked reductions in corruption, effective incentives (adequate pay, for example), appropriate institutions, modernizing cultures among the implementers, and adequate training and investigative and managerial resources: Lindsey, 1999a, 8; Ratliff and Buscaglia, 1997, 314.

The Plan, Briefly

The complex analyses Indonesians might want to consider, as bases for a reform process legitimated by a newly elected and hopefully democratic Government *(infra)*, are discussed in Brietzke and Timberg, 1999. A sketch of some likely reforms (admittedly, compiled by a foreigner) is offered here, to suggest the magnitude and scope of the political problems the new Government will face. This plan is divided into five parts. I, II, and III are the most important and time- and resource-consuming reforms. Ideally, they would begin immediately, since the success of other reforms depends on them: see the fifth precept, *supra.* IV describes important, sector-by-sector reforms that can arguably be pursued in almost any order, perhaps in response to political priorities, provided the consistency of the overall plan is kept in mind. V describes those reforms partly beyond Indonesians' control, with effects flowing indirectly from the reform efforts described in I—IV.

I. *Judicial Reforms:* the independent judiciary projected for Indonesia is dangerous, unless it is made more transparent and accountable through an effective judicial commission,

etc. A German-style Constitutional Court is also needed, but perhaps only after the Constitution is amended and thus capable of withstanding a searching scrutiny.

II. *Reforms in administrative law and agencies.* Indonesia has little law that applies beyond a specific agency or a specific regulatory task. Such a transparent and general public law—see the second and fourth precepts, *supra*—should be developed so as to promote efficiency and an accountability to the public, along with a deregulation and a selective re-regulation. The agency structure of the Indonesian bureaucracy should be modernized, to account for Government's new, democratic roles. This massive task should not be undertaken in the absence of sustained commitment from the new Government.

III. *Corruption* flourishes in the absence of judicial and administrative transparency and accountability. Reforms in I and II will thus reduce corruption: e.g., bribery is sometimes "efficient"—a cost-effective way to defeat regulations and judicial procedures so inefficient that they should be eliminated or replaced. But more is needed. While a good beginning has been made, there is much more to be done in legal terms.

IV. *Sector-by-sector reforms: see* note 2.

A. Barriers to entry into Indonesian *markets*, many of which are still fragile, thin or fragmented during the transition from a command economy, are best reduced, and markets strengthened and made more dynamic in the process, through a restrained *implementation* of the new Competition Law by the Commission. Especially important is the removal of regulatory barriers, such as those granting special privileges to cooperatives (*infra*) and other middlemen. Barriers to exit from markets can be reduced through an effective bankruptcy law (*supra*), and a useful Corporate Reorganization Draft Law is being prepared.

B. To strengthen markets and increase efficiency, redesign archaic contracts and property laws, and remove administrative law restraints on using these private laws: *see* II and the third precept, *supra*. Actors could then engage in *private law reform* by customizing their transactions and creating market *surrogates (supra).*

C. Indonesia's *Companies Law* is cumbersome, unrealistic (full of legal fictions, for example), and otherwise inefficient. Models from other countries suggest likely "corporate governance" reforms: increased duties of disclosure, to provide the information that promotes transparency, accountability, and sensible regulation; "international standard" auditing requirements, as essential to this disclosure; expanded fiduciary duties, owed by company managers to creditors, shareholders, employees, and perhaps consumers and citizens injured by pollution; the *locus standii* needed to enforce these fiduciary duties in a court; and a shrinking of that which shields a company from responsibility for, e.g., inefficiency—the "business judgment rule" that goes by various names. These reforms would lead to a more transparent and dynamic Stock Exchange, but separate reforms of the securities laws should also be considered. Increased regulatory burdens would admittedly result, but almost all existing regulations could be replaced during administrative reforms (II, *supra*)—in a net deregulation.

D. *Intermediaries* are the enterprises that are particularly underdeveloped in countries like Indonesia: banks, less formal and smaller-scale lenders like credit unions, insurance

companies, equity brokers on the Stock and Commodities Exchanges, and even coops and the creative use of contracts (*supra*) that is currently truncated in Indonesia: *see* precept three—over-determination. Details on reforms cannot even be summarized here, but they revolve around the relatively new economics of risk management, parallel reforms in administrative law (II, *supra*), and a more effective secured transactions law.

E. *State-owned enterprises* (SOEs) should be privatized where this will contribute to both Government revenues and an increased competition. Other SOEs should be effectively reorganized, and many could be run under performance-based contracts by managers from the private sector. These SOEs should cease being the prime beneficiaries of Governmental regulations (II, *supra*).

F. A formalization and deregulation of *informal proprietorships* (informal businesses of larger than cottage size) is probably the quickest Crisis 'fix', the easiest enhancement of an economic pluralism, a major control over corruption because it eliminates many bribe-opportunities (II. & III., *supra*), and a partial response to the demands of Indonesian populists. But populist policies of State allocation of funds for proprietorships would increase the inefficiency of markets and proprietorships alike. A better and cheaper regulation of the less formal end of the intermediaries sub-sector (IV D, *supra*) is a better solution.

G. *Cooperatives* have important potential roles to play in a pluralistic economy, roles which are impossible so long as coops are corrupted to serve elite purposes. In Brietzke & Timberg, 1999, I detail limited state roles and a legal accountability to coop members, rather than the special privileges and subsidies that create inefficiencies without benefiting coop members in the long run.

H. *Adat* (customary) institutions in the subsistence sector, all but ignored by State law and by banks, have important roles to play in development. Legal reforms must obviously be sensitive to local needs and cultures. An individualization of *adat* land tenures and institutions, sponsored by the World Bank, could be complemented by legal adoption (and some adaptation) of communal tenures and institutions. This process and non-regulatory Government assistance are sketched in Brietzke & Timberg, 1999.

I. The restrained but effective *implementation* of the new Consumer Protection and Competition Laws would increase consumer welfare, a popular way of gaining votes in a democracy. Effective *implementation* of existing environmental laws would reduce the involuntary consumption of pollution that injures all Indonesians. Labor law reforms should set the criteria for recognition of trade unions, criteria which impose responsibilities as well as rights, to increase the stability of business expectations and to foster unions as valued members of the new civil society (*infra*).

V. International efforts to regulate *multinational corporations* (MNCs) have made little progress, and Indonesian efforts to "tame" them would only reduce the inflow of capital and technology—while the MNCs keep their secrets and produce relatively more in other, less restrictive countries. Similarly, there is little progress in international-level exchanges of information about, and a modest regulation of, competition and the debt and equity transfers that can jump in and out of Indonesia at the click of a computer mouse.

The best Indonesians can do is effectively to implement reforms like those in I—IV, to convince foreigners that a more transparent and congenial economic climate is worth supporting. But the new Government does have important roles to play in trade promotion and finance. While a start has been made, the relevant (WTO, etc.) reforms must be *implemented* effectively.

Even if a conscious legal neutrality is pursued (*supra*), there will be failures in economic institutions (first precept, *supra*) that Government can and should do little to fix. The protectionism of the past has failed and, in a democracy, economic actors are *autonomous*: they have a right to fail as well as to succeed, free of elite interference and a State paternalism.

Some Political Considerations

Ideally, movement toward an Indonesian democracy will be used to build a consensus around further developmental reforms, and especially around the implementation of reforms in the face of opposition from vested interests. The new Government has an historic opportunity to legitimate its policies, in ways denied its less democratic predecessors, but an explosion of pent-up party and citizen demands will likely make it difficult to adhere to a consistent reform plan (*supra*).

Article 2 of Indonesia's 1999 Competition Law requires that business activities be "based on economic democracy…." What does this mean, when a political democracy is still evolving, and when the larger private and public institutions will likely remain rigidly hierarchical: "do what I tell you", or face an unpleasant like getting fired. (The "Motherhood" clause b in the Preamble to this Law defines economic democracy as "equal opportunity for every citizen to participate… in a fair, effective and efficient business environment….") Further, how does this goal relate to, and get balanced against, the other goals listed in Articles 2-3, the *jurisprudence* of this Law: efficiency, "equilibrium" between business and public interests, equality of opportunity among businesses of various scales, and the "people's [consumers' and laborers'?] welfare?" I argue that the reform plan, *supra*, offers a useful synthesis of these worthy but partly contradictory goals.

Perhaps the most distinctive feature of democracy is the demands citizens make, for the recognition of rights known to be irrelevant in pre-democratic states. Free speech, press, association, and participation are rights near and dear. But economists expect citizens to also demand the *property* rights that are stipulated imperfectly in existing Indonesian laws, and not at all in the 1945 Constitution or the international human rights covenants which Indonesia has ratified. Will this be a broadly Indonesian concern, since property rights provoke intense interest and disputes in other democracies?

In other democracies, many citizens demand very broad property rights in theory—"that's *my* ricefield (or ancestral forest)"—only to reject outright the unequal distribution of wealth and power that necessarily flows from *implementing* these strong rights in practice. (The fondness of the wealthy for strong property rights is easy to understand, but the poor support them as well—to keep and develop what little they have, in hopes of getting more through hard work.) This intransitive preference, as economists might describe it, endangers political stability since,

among other things, Government cannot afford or effectively implement the "welfare" programs needed to protect those with little or no property.

The only apparent escape from this (the economist Kenneth Arrow's) dilemma is democratically to implement community standards which *limit* property rights: to pollute, for example. These limited but more democratic rights in turn serve to limit governmental power—"Government can't do that to *my* property—and to legitimate the power these rights limit. Such a process involves a delicate balance: a government which takes too many rights away—through over-regulation—becomes undemocratic and reduces incentives to invest and produce, while a government with too few property rights retained cannot regulate sensibly or engage in the limited redistributions characteristic of a social democracy.

In a rather jurisprudential way, this analysis serves as a Weberian "ideal type" of policymaking in Indonesia, one which extends beyond property rights. But in the real world, vote-maximizing democracies tend to please the majority by taking privileges away from the minority. While this might result in an equalization of the legal terms of trade in Indonesia (an increased economic pluralism, *supra*), public inattention and its lack of full understanding of the issues enable elites to manipulate the policy dialogue in self-serving ways: *see* the second precept, *supra*. This places a great deal of pressure on underdeveloped media and civil society organizations, to shape the public debate effectively.

Papers delivered at a Tokyo Conference blamed the Asian crisis in large measure on the absence of civil society organizations, involved in development processes as a check-and-balance running from society to government and the economy: Salim, 1999. The hope is that strong and independent civil society organizations will obtain information about, support, and closely monitor the pockets of reform that always exist in a system subject to many political distractions. Carothers, 1998, 105; Sen, 1999; Ulen, 1997, 102. For example, pornography is a legitimate social concern in Indonesia. But opponents of reform should not be allowed to use it to curb a free *political* discussion in the media; that would be the pornography of power.

An NGO (non-governmental organization)-led "democracy from below" would help make the economy work for ordinary people, by mobilizing the previously unorganized or unorganizable, through institutions that are accountable to them, rather than to some elite politician. Even in a highly-regulated place like Hong Kong, consumer organizations play important roles in promoting competition and trade liberalization: World Bank, 1998, 9.

A final and distinctively legal value that deserves a strong political constituency in Indonesia is *the rule of law* that is tied to an independent and competent judiciary and Parliament. As the second of six demands on a huge banner, hung on Jakarta's landmark Welcoming Statue by the Student Forum in June 1999, put it: "Respect the Supremacy of Law" ("*Tegakkan Supremasi Hukum").* "Go With…", 1999. This rule of law would displace socio-economic hierarchies and a Dutch model of Guided Democracy, in the mediation of rights and reforms. *See* Carothers, 1998, 95-97; Goodpaster, 1999, 22; Lindsey, 1999a, 8; Lubis, 1999, 171-74. Fitzpatrick (1999, 75) says that Indonesians love syncretic compromises. We hope that the compromises over economic reforms (Weberian exercises; *see* the property rights discussion, *supra)* can be structured into a consistent plan, to give Indonesians the laws they have long deserved.

Endnotes

1. The currency (Rupiah or Rp.) was floated in August 1997, the Government requested IMF assistance in October, and 16 ailing banks were closed in November. In January 1998, rising prices and fears of shortages led to panic buying, and the Government agreed to IMF-sponsored institutional reforms and financial sector reforms—which included the guaranteeing of deposits in weakened banks. In March, President Soeharto was selected for a seventh five-year term. In April, bankruptcy law amendments, privatization of some state-owned enterprises, and steps toward the restructuring of corporate debts were announced. Riots, arson, looting, and rape rocked Jakarta and other cities in April and May, and Soeharto resigned on May 21. President Habibe, and his "First Development Cabinet" took office. In June, the "Frankfurt Agreement" was reached with foreign banks, in a largely failed attempt to deal with trade credit, inter-bank obligations, and corporate debt. Foreign donors pledged $7.9 billion in assistance, in Paris in July. After further reforms, the IMF announced Indonesia was in compliance with an economic stabilization and reform program that was later staunchly criticized as too deflationary. By October, the Rp. strengthened, from 15,000 to 7,000 = U.S.$1. Violent clashes between students and security forces began near Parliament in November. A modest economic recovery, fostered by successful and rather democratic elections on June 7, 1999, is jeopardized by a massive banking scandal and violence in Ache, Muluku, and East Timor.

2. Like many other economies, Indonesia's can be described in terms of nine sectors, each characterized by the distinctive legal regime which describes the sector's institutions: markets (property and contracts law, competition policy, etc.); foreign-dominated (especially multinational) corporations (which are often immune to regulation under domestic law), some with politicians', bureaucrats' or Government participation; domestic companies, some with foreign investors or politicians', bureaucrats' or Government participation; Government-controlled and –regulated enterprises; cooperatives and other nonprofit organizations; individual proprietorships of larger than cottage size; (near-) subsistence farming, fishing, forestry, and handicrafts/cottage industry; the international sector of trade and aid, debt, and equity inflows; and labor and consumers. Brietzke and Timberg, 1999. This focus on institutions and an institutional economics echoes a growing consensus, in Indonesia and among development theorists, that institutional capital is more important than the other forms of capital, viewed through a matrix of democratic-bureaucratic-legal system development: Trebilcock, 1997, 17-18,40. An institution involves formalized actors and repeated transactions that transform inputs (resources) into some valued output: democracy or (other) marketplace exchanges, for example. An institution has a history, a cultural context, and an interchangeable wealth and power. This power is used to resist changes, to change other institutions and environments, and to otherwise shape and restrict the choices of other individuals and institutions. For example, democracy is stabilized through institutions that decrease the stability of political cartels, and reduce the transaction costs of resistance to tyranny. Cooter, 1997, 135-36; Goodin, 1998, 7, 12; Trebilcock, 1997, 45. Good institutions are at least as important as good laws and personnel, given the institutional context of underdevelopment and unfavorable repetitions of behavior: Seidman & Seidman, 1997, 6-7.

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